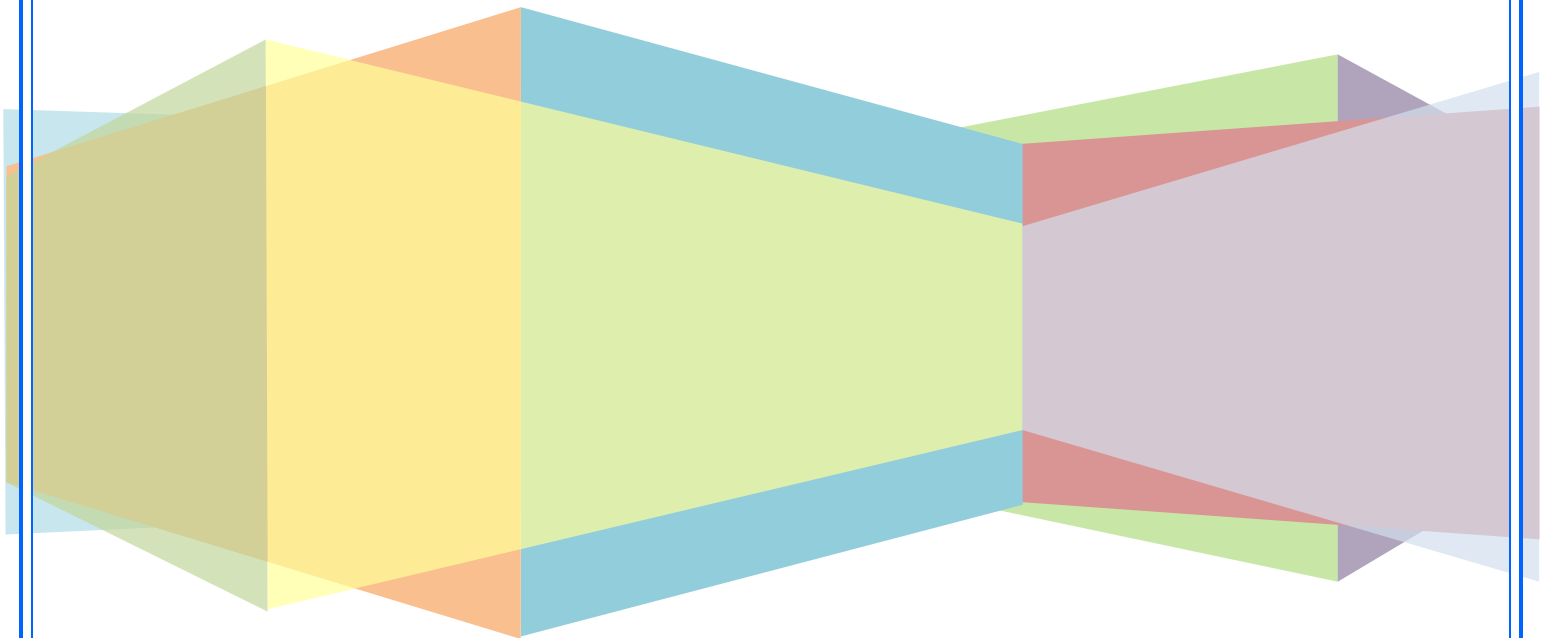


Yes, Governance Matters!

Corporate citizenry in the face of corruption

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CORPORATE CITIZENRY IN THE FACE OF CORRUPTION

INTRODUCTION

Corruption has emerged as one of the most significant threats to India's democratic framework. The nation-wide revolution spear-headed by Shri Anna Hazare reveals the extent to which corruption has adversely effected the lives of the common man. With the developments surrounding the Lok Pal Bill there is much talk and debate on the role of the government in tackling of corruption. There has, however, been little discussion on the role of India Inc. in the fight against corruption.

Corruption is a concern that corporations cannot ignore since it directly affects their ability to grow and compete. Corruption is principally an issue of governance – a failure of institutions and the absence of sufficient checks and balances. As a growth driver to economic development of the country and with the resources that it commands, the corporate sector can play an invaluable role in combating corruption.

LANDSCAPE OF CORRUPTION IN INDIA

Transparency International's Corruption Perception Index (CPI) ranks the world's most corrupt governments and its Bribe Payers Index (BPI) ranks the world's most corrupt corporations. According to Transparency International, the Corruption Perception Index, 2010 ranked India 87th with a score of 3.3/10 where Rank 1 denotes the least corrupt country and a higher score indicates lesser corruption.¹

Further, corruption in all forms has assumed disturbing proportions in India. The Indian corporate landscape has already witnessed various scams and instances of corruption, and the time has come for India Inc. to recognize their wider social responsibilities, enhance their relationships with stakeholders and take proactive steps to fight corruption in all its forms or in other words, to become responsible corporate citizens.

ROLE OF CORPORATE CITIZENS VIS A VIS CORRUPTION

Corruption is defined as the 'misuse of entrusted power for private gain'² and represents a critical business issue which is universally disapproved yet universally prevalent. It involves two main actors: giver and the receiver. As the typical source of corruption, corporations form significant part of the problem. There can be various types of corruption: state capture³, or grand corruption, and petty corruption, also known as grease payments or patronage⁴. For the purpose of discussion here, we have excluded private-to-private corruption, which are bribes that do not involve public officials that are solely between private companies; and facilitation payments, which are small bribes to speed up routine government services such as issuing licenses or permits.

While there is a strong business case for corporations to refuse to pay bribes since actual bribe payments are a direct cost to a corporation and involve huge reputational risk, many corporations view that they will

¹Source:http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results; last viewed on August 31, 2011.

²Business against Corruption: A framework for action, pg 9.

³In state capture, firms shape the regulatory framework through private payments to public officials.

⁴Petty corruption involves small bribes or favors in connection with implementing rules, laws and/or regulations

lose business and overall competitive edge, if they do not pay bribes, but their competitors continue to do so.

Though it may not always have been the responsibility of the private sector to fight corruption, but examples of various good practices are highlighted which indicates that the private sector can indeed take up the mantle and deal with the menace. Hence, there is need for significant collective action by the corporate citizens by leveraging their corporate brand, economic leverage, technical expertise in order to combat corruption in all forms and at all levels.

HOW DOES CORRUPTION AFFECT BUSINESS ENTERPRISES? - A CASE STUDY APPROACH

Corruption can lead to the following tangible and intangible consequences:

Tangible	Intangible
Directs costs	Constraint in attracting capital
Legal expenses and statutory liabilities	Loss of business
Black listing / suspension or cancellation of license / permits	Reputational damage
Lower return on capital to shareholders	Lack of drive to develop core competencies

Case Study: Diageo PLC⁵

In the U.S, the Securities Exchange Commission (“**SEC**”) on July 27, 2011 imposed a heavy fine of over USD 16 million on Diageo PLC (“**Diageo**”) for the violation of Securities Exchange Act, 1934 and the Foreign Corrupt Practices Act, 1977 (“**FCPA**”). This was because Diageo’s subsidiaries were found to have made payments to government officials in India, Thailand and South Korea to obtain sales and tax benefits.

It was concluded that due to lax oversight, failure to devise and maintain sufficient internal accounting controls the subsidiaries of Diageo indulged in corrupt practices. It was only after remedial measures being undertaken by Diageo such as employee termination and significant enhancements in its compliance program that the settlement offer made by Diageo was accepted by SEC and a civil penalty of only USD 3 million was imposed along with disgorgement and prejudgment interest of approximately USD 13 million.

⁵ SEC News Release, *SEC Charges Liquor Giant Diageo with FCPA Violations*, 2011-158 dated July 21, 2011

Case Study: Willis Limited⁶

In U.K., the Financial Services Authority (“FSA”) on July 21, 2011 fined Willis Limited (“Willis”) £ 6.895 million for failings in its anti-bribery and corruption systems and controls. These failings created an unacceptable risk that payments made by Willis to overseas third parties could be used for corrupt purposes. This is the biggest fine imposed by the FSA in relation to financial crime systems and controls to date.¹

The FSA imposed the fine on Willis due to *inter alia* the following reasons:

- (i) Willis failed to ensure that it established an adequate business case to demonstrate in each case why it was necessary for Willis to use an overseas third party to win business and what services Willis would receive from that overseas third party in return for a share of its commission.
- (ii) Willis failed to provide formal training to staff in this matter who only recorded a very brief description of the reasons for the commission payment and what services Willis would receive in return.¹
- (iii) Willis was unable to monitor the efficacy of its procedures.
- (iv) Willis did not ensure that adequate due diligence was carried out on overseas third parties to evaluate the risk involved in doing business with them or review such relationships to confirm that it was still necessary and appropriate for Willis to continue with them. For example, assess whether the overseas third party was connected with the insured, the insurer or public officials¹.

However, there were certain proactive steps taken by Willis at a later stage which were recognized as good practices and resulted in lowering of the penalty imposed such as:

- (i) Introduction of new measures to strengthen the independence of the compliance unit and improved the systems for documentation.
- (ii) Adoption of new policy which expressly required a business case to be established before entering into any arrangement or making payment to an overseas third party.
- (iii) Establishing that the third party was fit and proper to act on behalf of Willis.
- (iv) Due diligence to specifically include notes on whether the third party was connected to any public official or with the insured.
- (v) Annual review of all third party relationships.
- (vi) Training of compliance officers and disciplinary actions against those who failed to adhere to the policies.

WHY SHOULD CORPORATIONS TACKLE THIS PHENOMENON?

Given the significant tangible and intangible consequences of corruption, it becomes important for corporations to tackle this phenomenon. Grave consequences are faced due to corrupt practices coming into light, which are not only in the form of loosing public and consumer faith but also in the form of heavy civil, criminal and penal sanctions which could even wipe out a business entirely, as seen in majority of cases. For instance: In 2010, Nexus Technologies was indicted under the FCPA in U.S. for paying bribes to Vietnamese officials and ultimately agreed to cease there operations in U.S.A. and Vietnam.

⁶UK Financial Services Authority, *FSA Fines Willis Limited £6.895 Million for Anti-Bribery and Corruption Systems and Controls Failings*, News Release, FSA/PN/066/2011 dated July 21, 2011

WHAT ARE THE CHALLENGES FACED BY THE CORPORATE SECTOR IN COMBATING CORRUPTION?

Multinationals are subject to legislations of multiple jurisdictions

The anti-corruption legislations in majority of the jurisdictions have extra territorial reach extending to activities of subsidiaries operating in other jurisdictions and *vice versa*. For this reason, necessary checks and balances shall be established for compliance with anti-corruption laws of all jurisdictions where a corporate operates. Also, with complex group corporate structures, monitoring and controlling of each and every entity involved in the structure becomes a challenge. Further, an offence committed or an ongoing litigation on a group entity in one jurisdiction may lead to potential claims or litigations on other group company in other jurisdictions.

Cultural Relativism

Multinationals also face the problem of perception while undertaking business in different cultural domains. What a particular society considers right or wrong? - plays a major role in understanding the problem of corruption. Further, the extent to which a society expects corrupt behavior or distrusts government creates a cultural tolerance for corruption.⁷ However, as highlighted above being subject to anti-corruption legislation in various jurisdictions, these perceptual differences need to be ironed out for a corporation to protect itself against the legal consequences.

A High Risk Jurisdiction

The board of the companies must ensure that stringent compliance measures are in place and effective in all international locations, particularly those jurisdictions which are perceived to be high risk, corruption prone, emerging markets. For instance: Kraft Foods (“**Kraft**”) received a subpoena on February 1, 2011 from the SEC. The subpoena is connected to an FCPA investigation of a facility in India that was part of Kraft's USD 19 billion acquisition of U.K. based Cadbury last year. Kraft and Diageo cases are instances which indicate that regulators keep an extra strict vigil on the business operations of the companies in corruption prone jurisdictions.

WHAT CLUES CAN INDIA INC. TAKE FROM INTERNATIONAL TRENDS AND BEST PRACTICES?

Compared to other jurisdictions India is still at a nascent stage in developing effective anti-corruption laws. However, corporates due to their actions/inaction may be subject to proceedings in other jurisdictions. Hence, it becomes even more pertinent to adopt best practices which are not only in sync with laws of a particular jurisdiction but are globally heralded as corporate best practices

Highlighted next are some of the best practices followed by MNCs worldwide.

⁷The Corporate Private Sector's Role in Combating Corruption,
<http://www.perspectivesonglobalissues.com/0201/articles0201/PrivateSector.pdf>

Adapting with trends – Vodafone Group⁸

Vodafone Group incorporated a global anti-bribery programme to comply with this approach and aligns with the six principles of the UK Bribery Act:

1. **Proportionate procedures**: To ensure a consistent approach, but also allows local markets to tailor specific elements, to meet local needs and address particular risks.
2. **Top-level commitment**: The executive committee and senior management play an active role and receive regular updates.
3. **Risk assessment**: Each local market is required to undertake a preliminary risk assessment to identify and put in place anti-bribery procedures that are appropriate to their operating environment.
4. **Due diligence**: Risk-based approach extends to suppliers and business partners. Vodafone has also revised its contractual terms on bribery prevention.
5. **Communication & Training**: Has intranet page which provides all information related to the anti-bribery policy with supporting guidance. All employees and contractors have a duty to report any suspected breaches of the Code. An anti-bribery eLearning tool is available for senior management and being extended to all employees. Face-to-face workshops in high risk markets to ensure employees have a practical understanding of the key issues.
6. **Monitoring and review**: The global anti-bribery working forums, with representatives from each local market, meet monthly to discuss progress in implementing the anti-bribery programmes.

Getting the house in order – Siemens AG⁹

Siemens has since the penalty being levied for contravention of FCPA provisions, has significantly strengthened its compliance program and has implemented a three pillar program system:

- (i) **Prevent**: Unmistakable and consistently implemented policies and clear communication of their subject matter, along with training and ongoing consultation;
- (ii) **Detect**: Expanding the channels of communication with the ombudsman and help desk function;
- (iii) **Respond**: Clear consequences and an unmistakable response.

'Just say no' - BNP Paribas¹⁰

BNP Paribas expanded the scope of its internal controls by creating a Reputational Risk Committee

⁸<http://www.article13.com/UNGC/Vodafone%20anti-corruption%20case%20study.pdf>; last viewed on August 31, 2011

⁹<http://www.article13.com/UNGC/Siemens%20anti-corruption%20case%20study.pdf>; last viewed on August 31, 2011

¹⁰Article on – 'The Corporate Private Sector's Role in Combating Corruption', <http://www.perspectivesonglobalissues.com/0201/articles0201/PrivateSector.pdf>

(RRC)¹ which is not mandated by any legislation. The RRC analyzes the reputational consequences of engaging in business transactions by assessing the probability of future reputational damage, risk or loss. For instance, if BNP wanted to do business with Client X, the RRC assesses the reputational risk and the potential impact of doing business. If the RRC discovers that Client X has a history of fraud or extortion, then it determines that the cost of doing business is too high. As a result, BNP would pull out of a deal that could have yielded large short-term profits, but unpredictable and potentially catastrophic long-term losses.

Changing the rules of the game - GE in China¹¹

GE has adopted a three pronged approach in China to tackle corruption:

- (i) **Legislation:** GE Supports NGO efforts and engages with academics and policy makers to help develop legislations and provide for effective and fruitful laws.
- (ii) **Outreach Ministries and Business:** GE periodically meets with government ministries to address issues such as corruption and organizes seminars to develop creative techniques to combat corruption.
- (iii) **Education and Awareness:** Firm provides internal ethics material to state owned companies and government officials, hosts pro bono lectures on corporate law and legal compliance.

The above practices become relevant because in certain cases regulators under various jurisdictions explicitly use a “benchmarking” strategy wherein the regulators adopt an approach of being less likely to prosecute corporations that can demonstrate that, even though there was contravention of anti corruption legislation, it had a meaningful compliance program in place as benchmarked against the industry best practices.

HOW CAN THE CORPORATE SECTOR CREATIVELY CONTRIBUTE TO THE ONGOING FIGHT AGAINST CORRUPTION?

The private sector can generate creative and viable solutions in the fight against corruption both on the “supply side” (the private sector) and the “demand side” (the public sector). These efforts of the corporate citizens can influence other actors to do the same by collaborating with the government and civil society in knowledge sharing forums; by creating an ethical corporate culture through the increased importance of the corporate responsibility function; and by pushing the limits of current corporate governance models in pursuit of innovative solutions to reduce the risk of corruption.¹²

¹¹ **Source:** Greg Hills and ors., *Anti-Corruption as Strategic CSR: A Call to Action for Corporations*, May 2009

¹² Article on ‘The Corporate Private Sector’s Role in Combating Corruption : <http://www.perspectivesonglobalissues.com/0201/articles0201/PrivateSector.pdf>

Name of the corporation	Best practices adopted
Public sector units in India	Integrity Pact is a global tool developed by Transparency International, signed between companies and vendors undertaking that no bribes, gifts, kickbacks, or facilitation payments will be asked for or given during procurement. An Independent external monitor ensures adherence to such pacts. 40 public sector units in India have signed such Integrity Pacts. ¹³
Ford Motor Company	<ul style="list-style-type: none"> ➤ Rolled out mandatory online courses for employees on key ethical topics ➤ Provided in house anti-bribery training which dealt with gifts, favours, conflict of interest, internal control, fair competition and mutual respect. ➤ Recognised the challenges and provided open, accurate and honest reporting of the same.¹⁴
IBM Age Old Policy	IBM encourages employees to participate in political activity in their individual communities and countries. The company further enables to accommodate employees who need to be away from work while running for or holding political office, or fulfilling significant party duties during a campaign or election. However, IBM does not pay employees for time off for political activity so that it is not regarded as granting of political favours. ¹⁵
Shell	Publishes how much money from its oil and gas activities it pays to governments. Shell has also demonstrated its reporting transparency in its sustainability report by reporting about the violations of bribery and fraud. ¹⁶

CONCLUSION

To achieve success in the fight against corruption, corporations need to adjust their mindset and philosophy to include a broader anti-corruption agenda and align and integrate resources for effective application. Corporations are not a 'cure-all for all the problems' the country faces from corruption. However, companies have a business imperative to reduce corruption in critical growth markets and can play an integral role in developing meaningful solutions to this challenge.

The implementation of strong and effective governance techniques is not a guarantee that corruption would be eradicated. It remains to be seen whether India Inc. practices governance as a mere check-the-box initiative or for genuinely weeding out corruption emanating at corporate level.

¹³ Source: Article on 'Shadow of the Law' published in Economic Times dated August 30, 2011

¹⁴ <http://www.article13.com/UNGC/Ford%20anti-corruption%20case%20study.pdf>; last viewed on August 31, 2011

¹⁵ <http://www.ibm.com/ibm/responsibility/policy5.shtml>; last viewed on August 31, 2011

¹⁶ <http://www.article13.com/UNGC/Shell%20anti-corruption%20case%20study.pdf>; last viewed on August 31, 2011